The Organization of Non-Share Capital Corporations for Charities and Other Groups*

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Introduction

This paper is designed to highlight some of the pitfalls involved in acting for the non-share capital corporations of charities and other non-profit groups. The area of "organization" can be a pitfall for those of us in the legal profession because the statutory provisions which govern what can and cannot be done by non-share capital corporations are less familiar to us than the comparable business statutes and are often used by legal practitioners without a clear understanding of their limitations and peculiar attributes.

At the outset, I must leap to the defence of the non-share capital corporate practitioner. The non-share capital corporation has received considerably less attention than its business counterpart and therefore has lagged behind in the development of a statutory framework and in the judicial interpretation of its statutory rules. Many corporate lawyers have recently gone through the painful process of learning to refer to "registered" and not "head" offices and to deal with the fact that special resolutions can only be approved by shareholders' requirements of the new *Ontario Business Corporations Act.* Now we are assured that the manner in which non-share capital corporations are created and regulated is being monitored by the Ministry of Commerce and Commercial Relations. In the meantime we are left with cumbersome and either underdeveloped or non-existent precedents.

Organizing the Practice

The first organizational problem to be tackled by those who are dealing with non-share capital corporations has nothing to do with the organization of the corporation, but rather with the organization of the non-share capital corporate section of the practice. How can we organize ourselves and our practices to manage the work to be undertaken on behalf of the non-share capital corporate client in an effective manner?

Each practice may devise different answers to that question but to improve the standard of practice in the whole area we must share our information and experience.

In resolving the problem in my own firm we found first, that the governing statutes can be pared down to a more workable size and format. For example,

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in the case of the *Ontario Corporations Act* and its regulations, we took a statute of some 250 pages, and converted it to a compact reference code of only 35 pages. We indexed and noted the parts which apply to Part III corporations and then had a tool that was eminently suited to the needs of those in our firm who were practising in this particular area.

Secondly, we developed a handbook of comparative statutory provisions which set out the organizational provisions of the *Ontario Corporations Act* and the *Canada Corporations Act* relevant to non-share capital corporations and compared them to their counterparts in the *Ontario Business Corporations Act* and *Canada Business Corporations Act.*

Finally, probably the most helpful thing we did was to develop a non-share-capital charities team composed of two tax members and two corporate members and a clerk who was available to work full time in the area when demand dictated. This team approach may not be practical for small firms but I recommend it highly to those with sufficient resources.

Once the practice has been organized to deal specifically with the non-share capital corporation, practitioners will be in a position to move effectively and efficiently to provide the required service to the client but it will still be necessary to understand and avoid the pitfalls arising from the questions of by-laws, members, directors, officers, auditors, records and control mechanisms.

By-Laws

The by-laws of the non-share capital corporation, like those of the business corporation, must address many of the organizational issues at the time of the incorporation of the company. Both the Ontario *Act* and the Canada *Act*, like the comparable business corporation statutes, allow any provisions which may be the subject of a by-law to be introduced in the incorporating documents. Special provisions entrenching the by-law provisions are included in Item 7 of the Application. Contrary to requirements in the business statutes, the entrenchment is done at the request of the applicant to the appropriate ministry. These by-law provisions go into the letters patent at the minister's discretion and the requirement for approval is in keeping with the minister's discretionary powers over incorporation.

More importantly, you should be aware of the requirement under the Canada *Act* that the by-laws of a federal company must be approved by the minister. The by-laws must be submitted with the application for letters patent and are required to address certain matters including: conditions of membership, mode of holding meetings, mode of repealing or amending by-laws, with special provisions that the repeal or amendment of by-laws not embodied in the letters patent cannot be enforced or acted upon until the approval of the minister has been obtained.

The possibility of review has, in practice, proved to be quite restrictive of the creative provisions which can be embodied in the by-laws of a Canada

corporation. In contrast, the business statutes are modelled along the lines of the Ontario *Act* which contains a permissive mechanism for the making of by-laws which are not contrary to the *Act,* and are not subject to review.

The Ontario *Act,* but not the Canada *Act,* provides for the making of certain by-laws and resolutions in writing. Under the Ontario *Act,* any by-law or resolution signed in the first year by all of the directors is as valid and effective as if passed at a meeting of the directors called for that purpose. (Note that this provision is restricted to the corporation's first year.) Resolutions signed by all of the members during the first year only are as valid as if passed at a meeting, but any by-law passed *at any time* may be confirmed in writing by all of the members entitled to vote. The most important thing to remember when advising a client as to the availability of consent resolutions and by-laws and, therefore, the requirement to hold meetings, it that the non-share capital corporation is much more restricted than the business corporation.

While the Canada *Act* provides that by-laws cannot be effective until approved by the members, and the business statutes provide for delays in the operation of by-laws in the Articles, the by-laws themselves or, in a unanimous shareholder agreement, the Ontario *Act,* present a trap for the unwary in that certain matters required to be covered by the by-laws are not effective until the by-law has been confirmed by at least two thirds of the members. Matters such as the division of members into groups and the delegating mechanism as well as the establishment of the executive committee carry a delayed-approval mechanism.

In practice it has proved to be a lot easier and, as a result, cheaper to deal with these delayed-approval provisions at the time of incorporation rather than by way of supplementary letters patent.

Members

The Ontario *Act* expressly provides that upon incorporation, members are not liable for the acts or liabilities of the corporation. You will not find a similar provision contained in the Canada *Act,* but subsection 20(1) of the *Canada Interpretation Act* excludes personal liability of members of a corporation who do not contravene the *Corporations Act.* Under the Ontario *Act* applicants for letters patent automatically become members on incorporation.

There is no limit on the number of members in an Ontario corporation unless the letters or supplementary letters patent or by-laws provide otherwise. One should be wary, however, of letting the number of members of an Ontario non-share capital corporation fall below three. Firstly, if the number of members falls below three and the corporation refuses, or neglects, to bring the number of its members back up to three, such refusal or failure can be regarded by the Lieutenant-Governor as sufficient cause to cancel the letters patent and dissolve the company.

While your clients may be somewhat surprised and even irked when told of the loss of the corporate existence due to a slippage in membership, I can guarantee this distress will be as nothing compared to their response when they find out that if the membership falls to fewer than three for a period of more than six months, they are severally liable for the payment of the whole of the corporation's debts contracted during that time and can be sued for the debts without joinder in the action of the corporation or of any other member.

Even in a small charity which is closely controlled by its founding members it may be wise to have a separate class of non-voting members which can be quite large and consist primarily of donors. (The three-member minimum does not distinguish between voting and non-voting members.)

With regard to the meetings of members, it should be noted that while the *OBCA* now provides that unless the *Act* or the by-laws otherwise provide, the chairman presiding at a members' meeting does not have a second or casting vote in the case of a tie, the reverse is true under the Ontario *Act* where the chairman at a members' meeting still has a second or casting vote in the case of an equality of votes, unless the by-laws otherwise provide.

Directors

Under the Ontario *Act,* the number of directors must be fixed and cannot be fewer than three. All directors must be members, or must become members within 10 days of their election. Each director must be at least 18 years of age and cannot be an undischarged bankrupt. Interestingly enough, the Ontario *Act* does not make the director's soundness of mind a requirement for service.

Under the Canada *Act,* at least three of the applicants for letters patent must be first directors who must be at least 21 years of age and have power under law to contract.

Apart from the corporate requirements governing directorships, it is necessary to review carefully the requirements of Revenue Canada since it may not be enough simply to satisfy the corporate requirements for director qualifications. For example, Revenue Canada requires that charitable organizations have an independent board of directors, i.e., that more than 50 per cent of the directors, officers or similar officials must deal with each other and with the organization at "arm's length".

Officers

The Canada *Act* requires that the appointment, removal, powers, and remuneration of officers be dealt with in a by-law. No specific officers are required and the definition of officer is inclusive. The Ontario *Act,* however, provides that an Ontario non-share capital corporation must elect a president who must be a director. The Ontario *Act* allows for the election by the director of a chairman of the board from among the directors only if authorized by special resolution. If this office is authorized, the directors can assign all of the duties

of the president or any other officer to the chairman, but the duties of the president must in that case be prescribed by special resolution.

Auditors

The Ontario *Act* does not provide for consent to the non-appointment of auditors. The Canada *Act* also requires that auditors be appointed. Under each statute if no auditor is appointed, a member may apply to the minister for the appointment of auditors.

The Ontario *Act* requires that a notice of appointment be given in writing to the auditor "immediately" after the appointment. The Canada *Act* requires notice only if the auditor did not hold the office immediately prior to the appointment.

The auditor has the right of access to any records of the company required for preparation of the auditor's report. The right of access under both the Ontario and Canada *Acts,* however, is not as broad as that afforded to auditors of business corporations. The auditor's right only extends to officers and directors of the corporation under the Ontario *Act* and to directors and officers of the corporation and its subsidiaries, under the Canada *Act.*

Those who rely solely on their business corporate backgrounds and their familiarity with the *OBCA* when advising a non-share capital corporation might, for example, advise that there is no requirement to read the auditor's report at the annual meeting. They would assure the client that no one reads the auditor's report at annual meetings anymore. They would be wrong. In dealing with the auditor's report at the annual meeting of an Ontario non-share capital corporation, the requirement remains that the report of the auditor must be read.

Records

The details required in directors' and members' registers of a non-share capital corporation are more extensive than those required for business corporations. Both the Canada *Act* and the Ontario *Act,* for example, require additional reference to "callings of directors". The Canada *Act* requires a record of the "calling of all members, as far as can be ascertained."

Both statutes set out a complete list of what, and where, records should be kept. It is important to ensure that clients are aware of these record-keeping requirements and are advised to put systems in place to ensure that the necessary records are maintained.

General

While the issue of shareholder/member participation in the leadership, control and management of the affairs of a corporation has really only become prominent with the introduction, in the business statutes, of the unanimous shareholder agreement, it may not be readily apparent to some

practitioners that even without this mechanism there are opportunities for control open to members in the non-share capital corporation.

Previously noted, for example, is the ability to set up separate classes of membership with one voting and one non-voting class so as to rest voting control in the founding group. A provision in the letters patent restricting the transferability of membership can also be of assistance in maintenance of this control.

The fundamental instrument of control is, of course, through the electoral process. Those who control the votes control the corporation since, if the members are not content with the manner in which the leaders execute their offices, the members will decline to re-elect the leaders when their terms expire.

In this regard there is provision in the Ontario *Act* not only for the election of directors by the members, or certain members, but also the ability to provide in the letters patent or by-laws that the officers of the corporation be elected at a general meeting of the members.

Other control mechanisms may be built into the governing by-laws and letters patent. For example, the members may have a right to require advance member approval of certain types of actions. The most common of these is the limitation imposed on the powers of directors to borrow money on the credit of the company. Because the borrowing by-law is not effective until it is confirmed by a two-thirds majority, restrictions can be built in from the outset of the operation of the by-law.

Both the Ontario *Act* and the Canada *Act* include provisions which allow a member to requisition a meeting to deal with a specified matter. One caution in calling upon this tool should be noted with regard to the question of reimbursement for expenses. The *OBCA* provisions give the broadest protection on the question of reimbursement, i.e., they allow for reimbursement for expenses incurred on requisition as long as members have acted in good faith and in the interests of the shareholders generally. Reimbursement can only be rejected on the grounds that these conditions have not been met. However, both the Ontario *Act* and the Canada *Act* allow the members, by a majority vote and without specified grounds, to reject the repayment.

Lastly under the Ontario *Act* any member who is aggrieved by the failure of the corporation or a director, officer or employee to perform any duty imposed on it or them by the *Act,* may apply to a court for an order directing the corporation, director, officer or employee to perform such duty and the court has broad discretion to make any order the judge thinks fit.

These are, therefore, some of the peculiar attributes of the non-share capital corporate statutes that can prove to be pitfalls for the unwary legal practioner who must deal with non-share capital corporations. I hope that others will profit from my experience.